SEPTEMBER, 1946

BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

Control of Agricultural Prices Continued

But New Law Sets Special Limitations

The notion has become rather general in some quarters that under the new price control extension act agricultural commodities are largely exempt. While such commodities are subjected to special treatment under the new law, it is erroneous to infer that they are exempt.

Before going specifically into the provisions relating to agricultural products some general considerations involved in the new act are worth reviewing. The act directs that the Office of Price Administration and other Governmental agencies use their powers, including powers over prices and subsidies, to "promote the earliest practical balance between production and the demand therefore of commodities under their control" and that price and subsidy controls be terminated as quickly as possible consistent with this objective "and in no event later than June 30, 1947."

The act directs the President to recommend to Congress as soon as practicable and before January 15, 1947, the measures and policies which he deems necessary to supplement existing controls of prices and wages with a view to terminating all controls by June 30, 1947, without danger of further inflation. He is further required to report to Congress before next April 1 what commodities and services are so critically short as to require continuances of price control powers beyond next June 30.

On non-agricultural commodities the act requires the termination by December 31, 1946, of price controls where the commodity is not important in relation to business costs or to the costs of living. The ceilings on any non-agricultural commodity are directed to be removed whenever the supply equals or exceeds demand, including proper allowance for inventory requirements. Finally, if the supply of a non-agricultural commodity falls below demand for a reasonable period of time, the Administrator is required to reinstate price control of the commodity with the advance written consent of the three-man Price Decontrol Board established by the act.

SECRETARY OF AGRICULTURE GIVEN POWERS

There has been much discussion of the special treatment accorded agricultural commodities in the new act. Many appear to have the impression that there were in effect no controls written into the law covering farm commodities and their products. However, the machinery for regulating agricultural commodity prices is fairly elaborate and somewhat complicated. Most significant of the changes wrought by the new law is the augmented authority given to the Secretary of Agriculture over farm commodity prices.

On the first of each month the Secretary is required to certify to the Price Administrator the agricultural commodities for which he believes that the supply is less than demand. Each month the certified list is to be corrected. The law forbids the application of maximum prices on any agricultural commodity not so certified. In other words, the dropping of a commodity from the Secretary's certified list is sufficient to end existing price ceilings for that item, and conversely, the certification of a commodity as being in short supply is necessary before its price can be again put under a ceiling. But even on items certified as short in supply the Secretary of Agriculture is empowered to recommend upward adjustment in maximum prices if he finds that existing ceilings are impeding production, and he is further authorized to recommend the price adjustments he finds necessary to increase production. On all agricultural commodities which the Secretary finds to be unimportant as business costs or living costs, he is required to recommend the removal of maximum prices. His determination with regard to such products must be completed so that he can recommend elimination of ceilings on all such commodities by December 31, 1946.

Where maximum prices on an agricultural commodity have been removed and subsequently there develops a situation of demand in excess of supply, provision is made for reimposition of ceilings. When the Secretary of Agriculture determines that the item is in short supply he is permitted, with the consent of the Price Decontrol Board, to recommend to the Price Administrator the re-establishment of maximum prices if he believes such action is necessary to achieve the purposes of economic stabilization and prevent inflation.

Following upon recommendations by the Secretary either as to adjustments of maximum prices or the removal of ceilings on items which he determines to be unimportant as to business costs or living costs, the Office of Price Administration is required to take the recommended steps. Such action must be taken within ten days after receipt of the recommendation.

DEFINITIONS RAISE PROBLEMS

For purposes of clarifying the intent of Congress the law specifically defines certain terms. Two of these are of interest here. The term "agricultural commodity" is defined as "any agricultural commodity and any food or feed product" manufactured or processed in whole or substantial part from any agricultural commodity. Since the passage of the law two rulings have been adopted further clarifying this definition. Fish and fish products have been ruled to be agricultural commodities.

Congressional attempts to make the definition of an agricultural commodity precise still left a gap that raised jurisdictional questions for the Price Administrator, particularly because of the power given the Secretary of Agriculture over agricultural commodity prices. This question arose over how

(*Continued on Page 5*)

Two Postwar Booms Compared

Will 1919-21 Experience be Repeated?

Erosion and relaxation of price controls have drawn current business and public attention almost magnetically to the uncontrolled "boom-and-bust" readjustment of 1919-21 which followed the close of World War I. Wholesale prices, belying deflationary forecasts made at and shortly after the Armistice, soared from 197 per cent of the prewar figures in February 1919, to 272 in May 1920, and then collapsed to 138 in January 1922 after 20 months of the sharpest price deflation this country has ever known. Cost-of-living figures followed the same pattern, as shown on the accompanying chart. Output, income, employment, and wage rates fell as well, once the peak was passed. Rents continued to rise; the housing shortage remained acute until 1924.

Will prices continue to spiral upward? What month of what year may correspond to May of 1920? Can a downturn be avoided or at least minimized? These are key questions confronting bankers and other business leaders in the present situation. Some observers stress the similarities between the two postwar periods. They consider 1946 as "1919 over again," and prophesy varying degrees of collapse in 1947 or early 1948 at the latest. Other observers, usually more optimistic, stress the differences between 1946 and 1919. Some of these see another "New Era" of prosperity extending for at least four or five years and interrupted by nothing more than mild hesitations.

SIMILARITIES IN THE PATTERNS

Most of the obvious surface elements in the economic pattern of 1946 are strikingly similar to those of 27 years ago, but as will be seen, there are many significant differences. A demobilization and a reconversion, each more than twice the quantitative magnitude of its earlier counterpart, have been accomplished more slowly but at least as smoothly in 1945-46 as in 1918-19, except in a few fields (notably automobiles) which did not convert fully to war production in 1917-18. Reconversion was accompanied by crippling strikes in both cases, even the industries affected being frequently identical (coal, steel, and railroad transportation).

The preponderance of "expert" opinion forecast serious deflation and unemployment after the 1918 Armistice as well as after V-J Day. The following prognosis, for example, might have been written by a Government spokesman on the eve of V-J Day. It actually was written in November 1918 by the economist for a large New York bank:

> The belief that there will be a drastic drop in prices is based on obvious conditions. With a vast volume of labor rapidly being discharged from munition factories the world over to resume the production of normal supplies; with steel, copper, coal, shipping and other essentials released; with 50,000,000 soldiers returning to farms and factories, there will be an immense increase in the volume of goods available for civilian consumption. Prices should fall, even before this actual transformation is carried far, because wholesale markets commonly forecast impending changes.

The pressure of postponed demand proved more powerful than these deflationary forces after each war. After minor downward readjustments, prices and wages rose, thus far at slower rates in 1946 than in 1919. Some controls were taken off in each case with great haste, and makeshift substitutes had to be improvised subsequently; the decontrol process has been considerably slower in 1945-46. Real estate and securities have followed the same general upward pattern in prices as in 1919. Consumer demand again appears strong and tends to be concentrated in luxury lines, although no single commodity is playing the role of the 1919 "silk shirt" and although the current buying wave may not have reached the recklessness indicated by this Boston report to the *Federal Reserve Bulletin* for September 1919:

> An interesting sidelight on the psychology of the current attitude of the public toward the high cost of living is furnished by an instance cited of a lot of shoes which were moving slowly being cleaned up at once when the price was raised $1 . . . So much of the call is for the better grades of shoes that one manufacturer reports parts of leather left over are being sold to Europe rather than being used in cheap shoes which do not have a ready market.

As wages and prices pursue each other upward, they are again accompanied by vociferous complaints of high labor mobility and low labor productivity. *Business Conditions,* referring to the Seventh District specifically, provided in August 1919 what could pass for the opinion of some business men today:

> A very large part of the answers to our current questionnaire make particular complaint about the decreased efficiency of workers, not merely because of shorter hours, but because of the marked letting down of interest in work and a growing desire to live for amusement, self indulgence, and luxury. The matter is thus summarized by one of the great mercantile leaders: ". . . I see no solution of the problem except to increase production and decrease consumption. The workers cannot get the goods they want if they do not make them in sufficient quantities; and when they work for eight hours only, and sometimes only five days a week, they cannot expect to find all the goods they want in the retail stores when they go to make their purchases . . . Interested people should urge upon the workers of this country the necessity of working longer hours for the next six months, in order to bring up production for the needs of the people of this country and of the world. Nothing else will do it." Another says: "Many workers spend their time at the movies, and their minds seem to be on airships and automobiles more than on their day's work. This causes lack of production and, following the natural law of supply and demand, the prices of commodities move upward."

High mobility of labor was a particular complaint in agricultural regions because of the lower wages and longer hours of farm labor. For the Seventh District, *Business Conditions* warned in March 1920:

> There is considerable apprehension over the farm labor supply in all parts of the District. Advices are that it is impossible to hold an unmarried man as a farmhand except on terms offered by city manufacturers, namely short hours and high hourly rates.

THIS MONTH'S COVER

Carnegie-Illinois South Works at Chicago

(Courtesy of Carnegie-Illinois Steel Corporation)

Abundance of money and low interest rates were cited in 1919 as in 1946 as possible causes of inflation, though the rates paid on Liberty Bonds (4½ and 4¾ per cent) seem extravagantly high at the present time. As early as April 1919, the Federal Reserve Board called attention to the concentration of the World War I debt in the banks and to its inflationary consequences:

> Complete restoration of prices to their eventual normal basis, whatever that may be, cannot be expected to occur so long as the war loan securities of all kinds continue to rest in any very considerable figure in the hands of the banks. It is therefore strongly to the interest of the public that as rapidly as possible such war loan paper should be eliminated from the banks.

The principal individual scarcities, both in 1919 and in 1946, have been sugar, textiles, shoes, automobiles, and above all, housing. In the housing field, quotations from 1919-20 issues of *Business Conditions* for the Seventh District would appear current with the references to rent increases replaced by notes on devices for evading rent controls.

> The housing situation is looming up as a serious problem in practically all the industrial centers of the Middle West . . . Conditions in Chicago a year ago were such as to bring into use for winter housing places built for summer use only . . . Apartments in Chicago which for many years had been idle and almost ready for condemnation are again pressed into service, and several families in many instances are "doubling up." The so-called middle class of salaried people . . . also have found the scarcity of dwelling space a serious factor in their living costs, with home seekers bidding up rentals against each other to extreme figures. Rentals have advanced from 20 to 75 per cent and even 100 per cent . . . The kind of homes which appear to be chiefly in demand are the 4-, 5-, and 6-room apartments. The one and two room kitchenette apartments are more frequently constructed because of the income they return to the owner . . . At the present rate, authorities estimate from four to ten years will be required to overcome the housing deficiency. (*December 1919*)

> The scarcity of labor in some sections of the District is traceable to a shortage of housing facilities. Plans in Chicago and other manufacturing centers to utilize portable houses made for the Government in war times, promise some relief. (*February 1920*)

> The traditional irresistible demand for more houses and rentable rooms continues to beat its head against the immutable difficulty of building on the present levels of wages and structural material costs . . . Masons, carpenters, plasterers, hod carriers, plumbers, and the rest of the structural trade demand such compensation, and the cost of lumber, mill work, cement, sand, stone, wire nails, and plumbing supplies rules so high that it is an exceptional financier who can see any profit in building houses for the necessitous. (*August 1920*)

SIGNIFICANT DIFFERENCES LISTED

Of the significant differences between the economy of 1946 and the economy of 1919, some induce optimism and some do not. While some of the differences are less immediately apparent than the similarities, they nevertheless present an imposing list, including these:

1. There is a considerable difference in degree, although similarity in pattern, between the World War II and World War I rise in circulating money (including demand deposits in commercial banks). The total nearly tripled in World War II, as against a doubling in World War I. As for Government debt, the World War II rise of 225 billion dollars is close to ten times that of World War I. Despite these monetary factors, prices have thus far risen much less rapidly than during and after the earlier war. The more comprehensive price, rationing, and other controls of World War II channelled a greater proportion of the increased money incomes into liquid funds whose volume is now estimated at over 225 billion dollars, or more than three times their 1919 level.

2. On the other hand, peacetime productive capacity in 1946 also far exceeds the capacity of 1919, both by reason of the advances made during the interwar period and because of the greater volume of convertible war plants built during World War II. In per capita terms and related to the standard of living, however, this difference is less significant.

3. The price-wage race of 1919-20 was won by prices, by a wide margin. Many of the major strikes were labor defeats. The breaking of the 1919 steel strike in particular may have postponed mass unionism for 18 years. The major strikes of 1945-46 have all been union victories, partial or complete, although they have not prevented some decline in real hourly and weekly earnings from their wartime peaks as prices have risen and hours declined.

Greater economic power of organized labor makes the danger of early collapse from prices outrunning purchasing power less than it was in 1919—although the majority of workers participate indirectly, if at all, in the gains of the organized minority. The danger of further inflation via wage increases leading to eventual disaster is, however, greater and likewise the danger of delayed production through successive waves of strikes.

4. The price increases of 1919-20 were concentrated in clothing and in rent. Food prices had turned downward at wholesale, although not at retail, within a year after the close of hostilities in Europe. In 1945-46, with rents under relatively strict control, and the world food situation far more unsatisfactory than in 1919, the price increase has been concentrated in food and clothing. The higher level of farm prices for foodstuffs and textile raw materials in 1946, combined with a lower level of rents, is an additional factor tending to support purchasing power to a greater extent than the 1919-20 pattern of relative prices, since the proceeds go to lower income groups. According to ex-President Hoover, however, the world food crisis should pass its peak during the autumn of 1946. If this forecast is correct, the relative price pattern may be expected to shift in 1947 somewhat closer to that which prevailed in 1920.

5. The United States is far more removed from the direct influences of foreign business conditions at the present time than in 1919. The American export balance in 1919 exceeded 4 billion dollars and caused a sharp fall in the foreign exchange rates of the leading customers as dollars became scarce abroad. This fall led to a decline in exports early in 1920—perhaps the initial indicator of the general downturn which came in the late spring and early summer. The current demand for American exports is rising, but the export balance still comprises a noticeably smaller percentage of the national product. While some foreign exchange rates have fallen, others have been pegged, and a few have been increased as protection against further American inflation.

On the import side, American accumulation of inventories of foreign products (particularly Japanese silk) supported great booms abroad. These booms collapsed when American imports dropped back to the level of current con-

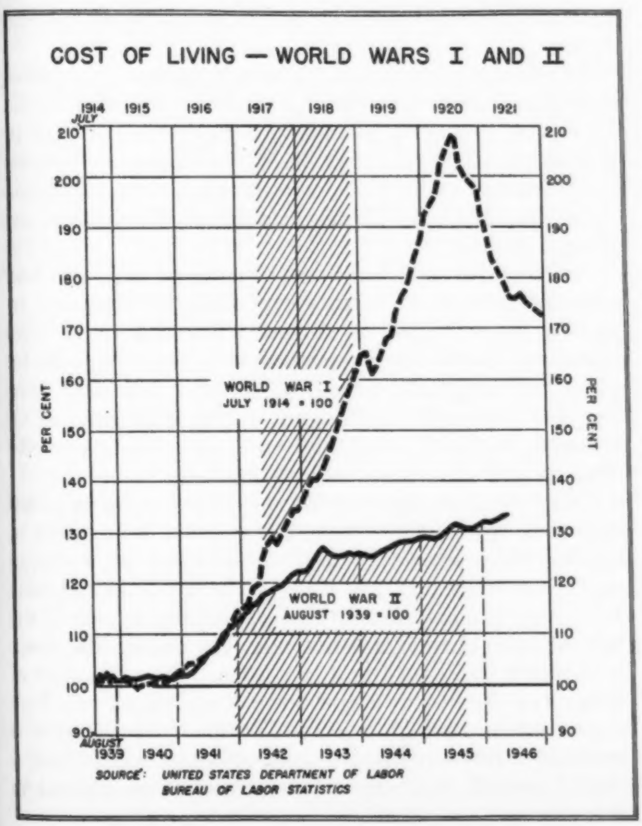
sumption. The foreign crashes which began in Japan led in turn to the forced devaluation and liquidation of inventories held by American industry, particularly textiles and sugar, which featured the summer and fall of 1920. Accumulation of foreign raw materials by American industry has not yet taken on the scale of 1919-20, principally because of the lower productive capacity of the potential suppliers and the development of synthetics in this country.

Crises in other booming nations heralded the collapse in America in 1920, whereas at the present time the United States is unlikely to feel any serious immediate repercussions from a slump abroad.

6. Doctrinaire opposition to peacetime economic controls is less stern and uncompromising than it was in 1919. Such passages as the following (*Commercial and Financial Chronicle,* November and December 1919) are still common in business publications, but carry less conviction:

> We shall in peace soonest return to our former state if we administer this temporarily continuing control with the sole view of getting rid of it as fast as possible, in order that new and larger expansion may ensue under the natural laws that exist, always pulling and always powerful, laws that we will not, cannot abrogate, though we may seemingly defy them and interrupt them, laws ordained in the constitution of things, made for men's benefit and working for his good when, and only when, he obeys their divine edicts.
>
> The first lesson we should learn is that mighty forces are resuming of themselves their control of human destiny and in accordance with the beneficence of creation—and that therefore we have nothing really to fear, if only we live in the light of mutual benefits that lie in mutual interests.

When and if deflation comes, Governmental supports already available will accordingly be stronger than those applied by the Wilson and Harding administrations. Once prices had started to slip in 1920, the ruling psychology of "normalcy" involved allowing them to fall—to the prewar "normal" if necessary. As for the unemployment that accompanied the price fall, the United States Employment Service's activities in placing returning servicemen had ceased March 4, 1919, with expiration of the agency's funds, and no Federal agency was available for assistance. Although by no means precluding some downward movement, current expectations are against tolerance of any repetition of the 1920-21 price fall or the accompanying unemployment, let alone its acceleration by the "tight money" policy of the same period. Agricultural prices in particular led the 1920 downturn; the political pressure of farm groups may well prevent their falling so fast or so far again. Support programs are established and under way which, if effective, will minimize any second postwar collapse, at least in the short run.



7. Inventories still appear low relative to sales, although it is difficult to measure them adequately in their present unbalanced condition. A slight fall of demand, moreover, may cause inventories to rise with tremendous rapidity under conditions of capacity production. Inventory controls continue to exert a stabilizing influence, and to the extent of their effectiveness, constitute a limiting force upon manufacturers, wholesalers, and retailers not present in 1919-20.

Fragmentary inventory statistics for 1919-20 indicate only a moderate rise in physical volume until the latter year. Deterioration of railroad equipment combined with a succession of railroad strikes to delay deliveries after production of basic raw materials had been resumed. A continued and intensified box-car shortage during the fall and winter of 1946-47 might well have a similar effect. Acceleration of deliveries in the winter and spring of 1919-20 rendered inventories suddenly excessive, particularly in the East, though widespread complaints of shortages had been reported as late as April in the Chicago, San Francisco, and Dallas Federal Reserve Districts. At the same time, reduced availability of credit and rises in money rates, which had been delayed in order to assist the Treasury in floating the Victory Liberty Loan and in stabilizing the bond market, forced inventory liquidation at price sacrifices, and the slump was under way. Frequently mentioned as an opening event, analogous to the stock market crash in October 1929, was a 20 per cent slash of prices "across the board" by a leading New York department store early in May.

8. There is more general awareness of the dangers inherent in the current situation than there was after World War I. More and better economic guides are also available for the interested. The memory of 1920-21, moreover, is still tangible to the middle-aged and elderly population in all economic classes. This now prompts hesitancies and misgivings which were confined after World War I to a vague, uncomprehending "This can't last," compounded primarily of emotional and moralistic factors. This psychological difference cannot be measured, but its operation can be suspected as a factor reinforcing remaining controls, promoting buyers' strikes, inciting consumers and others to endure scarcities while waiting out the boom, and otherwise retarding and diminishing the postwar inflationary peak.

MYTH OF THE BUYERS' STRIKE

The mythology of the 1920-22 depression features a "buyers' strike," in which the consuming public suddenly revolted without benefit of organization, came to work in barrels and overalls in protest against clothing prices, and reversed four years of inflationary trends. The facts support this view only in part. Of the existence of "buyers' strikes" in 1919-20 there is no doubt. Their effectiveness is dubious until prices had already passed their peak, when postponement of purchases had obvious economic advantages in addition to resentment against "profiteering." The 1946 "buyers' strike" movement, however, has organizational advantages over its predecessor, manifested particularly in closer relations with the labor movement.

Mention of sporadic instances of "buyers' strikes" can be found in economic periodicals as early as August of 1919. They were small-sized, local, short-lived, and confined to a few commodities and stores. *Business Conditions* for January 1920—five months before the turn—summarized their effect in the Seventh District:

> On one side there are forays against high prices. Society women engineering film propaganda and quasi-boycotts against this or that commodity at the prevailing price; or else pledging themselves to refrain from buying until concessions are made. On the other side there is the obstinate fact that demand for commodities outruns any possibility of providing a supply . . . "The wish is father to the thought," apparently, when it is asserted that "prices are on the point of breaking." Occasionally, it is true, there appear advertisements announcing "big cuts" in prices; and these are heralded as the beginning of the era of forced liquidation and of declines in the cost of living. Investigation fails to show that these "leaders" represent the facts of the general market.

At least one "buyers' strike" in the spring of 1920 appears to have backfired, as the following account indicates:

> In April 1920, a movement began in the South, which soon spread to other parts of the country, to induce men to wear overalls. This movement was intended as a protest against the high price of men's clothing, and it was argued that a decrease in the demand for ordinary suits of clothes would effect a reduction in the price. An immediate effect was to increase materially the price of denims, of which material overalls are made.

The "buyers' strike" movement in its cumulative aspects certainly added to the severity of the crash and deflation of the latter half of 1920, and therein lies its importance. There is no evidence that it caused the downturn or even affected its timing materially. Statistics on department store sales indicate a downturn only in July, lagging behind the peak in the cost of living. This timing is difficult to reconcile with the "buyers' strike" myth.

SUMMARIZING THE OUTLOOK

Unless the parallels between 1947 and 1920 prove to be closer than those between 1946 and 1919, it will be dangerous to rest estimates of the future course of business exclusively or even primarily on this historical analogy. A substantial number of business analysts in private and Government service nevertheless have become or remain frankly pessimistic as regards business prospects for 1947-48. Their tentative conclusions pose a dilemma: whether production rises further or remains at or below its present level, a downturn seems in the offing.

If wage-price-profit controversies lead to further waves of successive strikes, the American economy faces a period of inflation with output definitely below capacity, which would probably end in an early collapse when the savings of unorganized consumers are exhausted and their current incomes prove insufficient to support the going price levels. On the other hand, early resumption of full production would release productive capacities which may be too great for the market to absorb even at pre-June 30 OPA prices, and substantial deflations will be necessary in most industries.

There is basis for greater optimism, however. The probable consequences of continued strikes and inflation cannot be questioned. With regard to possible overproduction deflations, it is possible for price declines to come gradually, with a few industries at a time encountering apparent overproduction of final products while such key items as housing and automobiles remain scarce. If the gluts come gradually, the downward adjustments will be primarily in prices while productive services shift easily to other employment. Any general recession could be short and not very severe as regards total income and employment. If, on the other hand, substantial segments of the economy are faced with simultaneous overproduction, there is little hope of avoiding at least a temporary over-all setback.

DANGER SIGNALS

Points of difference between 1946 and 1919-20 appear to dominate the postwar business picture at the present time. Danger signals lie primarily in reversions to the 1919-20 pattern, reversions which are not inconceivable in the near future.

In addition to the usual business indicators (e.g. prices, production, income payments), inventory statistics should be subject to special attention. In many cases it may be desirable to supplement published over-all inventory statistics with estimates on individual items at all manufacturing and distribution levels, which may lead the official figures in any dangerous rises.

At least three other barometers of domestic trade will bear careful scrutiny: (1) indications of financial stringency requiring business firms to demand additional credit from commercial banks, (2) cancellations of business programs for plant and equipment expansion as wages and other costs rise, and (3) further indications of large-scale multiple ordering at any level, which may result in epidemic cancellations once heavy deliveries begin to be made.

Other pertinent figures relate to American international trade, and specifically to the export volume. A sharp rise in exports which cannot be maintained would be a danger signal here, since high and rising prices in this country may force American products out of world markets as soon as the normal scale of foreign production is resumed. The four-year British-Canadian wheat contract may be a symptom of things to come. If this nation becomes acclimated to a high export volume at high prices before foreign production is resumed, a fall may bring a severe shock, particularly if it should coincide with any important decline in demand in this country.

AGRICULTURAL PRICES

(Continued from Inside Front Cover)

to define precisely what Congress meant by "manufactured or processed in substantial part from any agricultural commodity." Conceivably questions of jurisdiction could be raised by misunderstandings as to what proportion of a product was an agricultural commodity. OPA has, temporarily at least, avoided difficulties on this score by arbitrarily ruling that any product containing 20 per cent or more by volume of an agricultural commodity is "an agricultural commodity" as defined by the law and therefore subject to the authority of the Secretary of Agriculture.

The other definition of interest relates to the meaning of the term "in short supply." In a way this is one of the crucial concepts in the law, for it is one of the most important criteria set up by the act as standards to determine whether a given commodity is permitted or required to be controlled. The law says simply that "an agricultural commodity shall be deemed to be in short supply unless the supply of such commodity equals or exceeds the requirements for such commodity for the current marketing season."

Without further clarification such restriction is useless as a guide almost to the point of being a joker. For any given commodity the requirement for the current marketing season is not some one absolute quantity. The market will demand a fairly wide range of quantities at various prices. Since the price to be paid is the whole matter at issue, the way in which "requirements" are to be calculated for purposes of estimating the adequacy of supply would conceivably leave the matter largely in administrative hands, to be arbitrarily determined.

In a sense this is a good illustration of the problems increasingly faced by administrators and legislators in attempting to achieve common policy objectives. There doubtless will be some commodities for which it will be easy to agree that they are "in short supply," but there will be probably others on which there will be controversy as to eligibility for price control because of differences of opinion as to what are the "requirements for the current marketing season."

The act specifically states that as to these price powers the Secretary of Agriculture is not subject to the direction of any other appointive officer or agency of the executive branch of the Government. He can at any time withdraw his approval of actions requiring his approval under the act, and such withdrawal makes rescinding of the action mandatory on the Price Administrator. No maximum price, regulation, or order can be applied to an agricultural commodity, or a service rendered in connection with an agricultural commodity, that had not been subject to such control prior to April 1, 1946.

COMMODITIES GIVEN DIFFERENTIAL TREATMENTS

The important agricultural commodities are singled out by the act for different kinds of treatment. On poultry and eggs, and leaf tobacco, and their products no ceilings can be imposed at all unless the Secretary of Agriculture finds that the price is unreasonably above the June 30, 1946 ceiling plus subsidy paid at that time, that the commodity is in short supply and price regulation is practicable and enforceable, and that the public interest will be served by the regulation. All three conditions must be met.

Ceiling prices were forbidden until August 21 on livestock, milk, and food and feed products derived from them; cottonseed and soybeans and their products; and grains. The Price Decontrol Board was charged with holding hearings and determining before August 21 which of these products are to be free from regulation. It may not restore price control unless prices are unreasonably above June 30 ceilings plus subsidies in effect at that time, unless the commodity is "in short supply" and the regulation practicable and enforceable, and unless the public interest will be served by the regulation.

Thus these products differ from poultry and eggs and leaf tobacco chiefly in that the latter are exempted from price control except by subsequent determination of the Secretary, while the former group (livestock, milk, grains, etc.) are subject to direct determination by the Price Decontrol Board.

Use of subsidies as a price control device is circumscribed in the act. The Price Decontrol Board is given power to determine whether or not and how much of the subsidies in effect June 30 on agricultural commodities may be reinstituted on commodities which it may put under price control. Those subsidies applying to agricultural commodities and petroleum are limited to 869 million dollars; such outlays must be progressively reduced and must be terminated on April 1, 1947. Furthermore, expenditures for these subsidies must be limited to 629 millions during the last half of 1946.

The Price Decontrol Board in its order of August 20 restored price control on livestock and meats, and on soybean and cottonseed products. Beef, pork, and veal were to be put under ceilings at approximately the June 30 level. Livestock subsidies in effect on that date were restored, but are required to be cut in half before January 10. The Board said it found that the prices of livestock, meat, soybeans, and cottonseed had risen unreasonably, that they are in short supply, and that therefore recontrol is required by the law.

Most grains and milk and milk products were continued exempt from control, chiefly because the Board found that prices of these items had not as yet risen unreasonably, but it warned that milk and milk products prices will be watched closely and controls restored in the event of unreasonable price rises.

It is probable that milk and milk products will rise as the coming season advances. It should not be taken as a certainty that these items are to continue indefinitely for several months without recontrol of their prices.

Soybeans, cottonseed, and their products were recontrolled because not only are they in short supply, but their prices have, said the Board, "advanced unreasonably." Most of the grains were, on the other hand, exempted because with present crop prospects it appears that very shortly the grains will be in plentiful supply.

Wisconsin State Finance — I

Seventy Million Dollars Earmarked for Highways, Veterans, and Public Works

The green years that characterize the finances of the states, beginning with 1940 and continuing through nearly a full fiscal year after the end of World War II, are reflected in the financial condition of the Wisconsin State Government by a tenfold increase in the cash and investment balance of the State's operating funds, a spectacular growth in tax receipts to these funds, and a relatively stable level of State expenditures exclusive of aids to local government. On the revenue side, the apparent financial vigor is occasioned by the enormously enhanced yield from the corporation income tax and by a less spectacular but substantial increase from personal income taxes despite the discontinuance of the emergency surtax which was in effect for the income years 1935-42, inclusive. On the expenditure side, the deferment of maintenance and capital outlays for highways and state institutions and the lag in price-level salary adjustments and pension aids are the significant considerations.

It may reasonably be anticipated that the resumption of an accelerated maintenance and replacement program for public facilities, together with the construction of new highways and public buildings, will at present cost levels make heavy inroads on the accumulation of liquid assets the State now holds. Moreover, the perpetuation of present price levels or a continuation of the upward trend will require substantial increases in operating disbursements and average aids to the aged and other pensioners. These factors, together with the prospective demands for the further expansion of State activities in veterans' assistance and rehabilitation, for example, even if unaggravated by a slump in the level of general economic activity and the consequent effects upon tax yields, will require a careful husbanding of the State's fiscal resources and favorable cash position.

The ability of the Wisconsin State Government to meet annual expenditure requirements is measured by the current productivity of its revenue system and whatever balance remains from the prior year's operation. Constitutional limitations on incurring short-term debt, as set forth in Article VIII, section 6, of the *Wisconsin Constitution,* are such as to preclude the use of temporary loans in an amount to exceed 100 thousand dollars. Section 6 states:

> For the purpose of defraying extraordinary expenditures the state may contract public debts (but such debts shall never in the aggregate exceed $100,000). Every such debt shall be authorized by law, for some purpose or purposes to be distinctly specified therein and the vote of a majority of all the members elected to each house, to be taken by yeas and nays, shall be necessary to the passage of such law; and every such law shall provide for levying an annual tax sufficient to pay the annual interest of such debt and the principal within five years from the passage of such law and shall specifically appropriate the proceeds of such taxes to the payment of such principal and interest and the appropriation shall not be repealed nor the taxes be postponed or diminished, until the principal and interest of such debt shall have been wholly paid.

A precipitous decline in State tax revenues, for example, with a nominal cash balance on hand, would thus require immediate legislative action, either to impose new taxes, to borrow from trust or earmarked funds, or to effect an offsetting retrenchment in State expenditures or aids to local governments.

OPERATING FUNDS

Of all the State funds, the General Fund is the principal indicator of the State's financial condition. Into it are deposited receipts from personal and corporation income taxes, public utility taxes, excises, insurance taxes, and death and gift levies. A large part of these taxes is returned to localities according to statutory distribution formulae; the remainder is disbursed for State activities in education, welfare, and miscellaneous functions of the several departments, boards, and commissions. The General Fund also receives all Federal aid (except that portion devoted to highway purposes), certain interest earnings, institutional receipts, and miscellaneous fees. Prior to 1945, when the legislature created the State Highway Fund, highway-user taxes were paid into the General Fund. Before 1931 the various school income funds were maintained as separate accounts; subsequently, state-supported institutions of higher learning, educational aids to localities, and other activities in the field of education have been financed through the General Fund. Other significant operating funds—World War I bonus funds, Conservation Fund, Postwar Rehabilitation Fund, and Postwar Construction and Improvement Fund—are financed largely by special, earmarked taxes or by General Fund transfers.

The record of State financial operations, as reflected by the funds discussed above, is shown in the accompanying chart and table for the period 1920-46. These data indicate that in most of the years covered, a close relationship between annual expenditures and revenues was maintained. Substantial Federal aid for unemployment relief bolstered State finances in the early depression years of the 1930's, but a comparatively large operating balance was the measure of financial security on which the State relied during the decade of the 1920's. In these years the balance at the end of the fiscal year was between 25 and 40 per cent of annual receipts or disbursements. Throughout the 1930's operating balances were at much lower levels, averaging approximately 15 per cent of receipts and dropping as low as 8 per cent in two years. Since 1940 the balance on hand has increased steadily; it is now at a record level of 100 million dollars, or over 60 per cent of 1946 receipts.

The fiscal year-end balances do not fully portray significant fluctuations in the daily cash position of the State's funds. Since their income is not a regular day-to-day flow but is concentrated around annual, quarterly, or monthly tax-due dates, and since many disbursements, particularly the payments to local units of shared taxes or aids, occur in

certain specified periods, the balance varies widely throughout the year. Some indication of the importance of these fluctuations may be obtained from the supplementary tabulation on quarterly balances for selected State operating funds in the accompanying table. It should be noted that there is more stability in the quarterly balances during the 1930's and 1940's than in the 1920's when a greater part of the revenues depended upon single annual tax payments.

Until 1945, when the legislature segregated highway funds from the General Fund, Wisconsin adhered rather closely in the management of State funds to the policy of non-segregation. Tax receipts, Federal aid, and the earnings of State institutions and agencies, with minor exceptions, were deposited in the State's General Fund. Disbursements for not only the regular activities of the State Government but also the aid and tax sharing of local units were met by withdrawals from that fund. There were numerous minor exceptions to this rule (see footnote 1 to table for a list of such funds), but segregation was largely confined to the World War I bonus funds, the Conservation Fund, the Unemployment Compensation Trust Fund, and various trust funds.

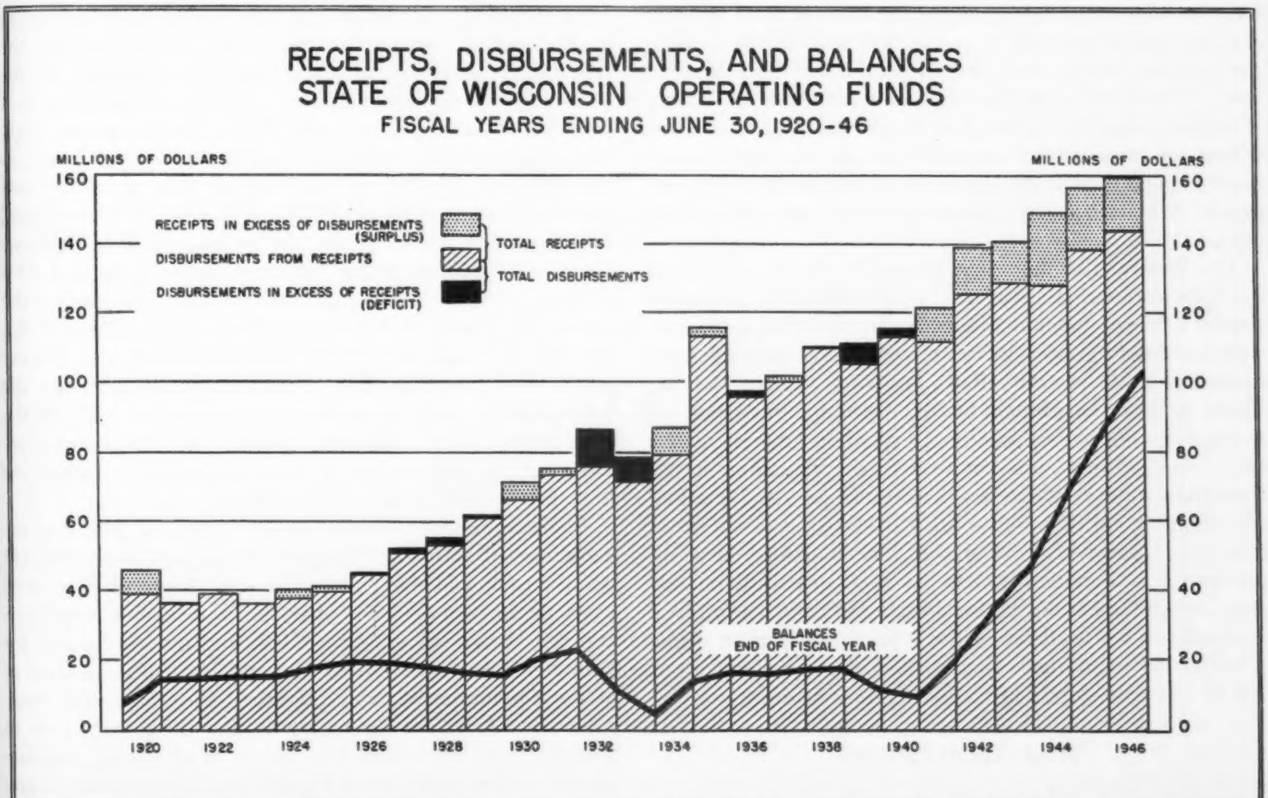
World War I bonus funds consisted of the Educational Bonus Fund supported by surtaxes on net incomes for 1918 to 1922, the Service Recognition Fund which was credited with a one mill levy on general property, and a surtax on net incomes of 1918. In 1923, balances in these funds were transferred to the Soldiers' Rehabilitation Fund and were made available for medical care to veterans with service-connected disabilities and for educational assistance to veterans and children of veterans who were killed in action or died as a result of injuries received during World War I.

The two major sources of revenue of the Conservation Fund are two-tenths of one mill levy on general property and all monies accruing from the various permits, license fees, and enforcement of the conservation laws. The Commission is required by law to spend the hunting and fishing license fees for the administration of the fish and game laws. Other disbursements are for supervision of forestry, park police force, maintenance of fish hatcheries, forest crop aid to counties, and other activities related to conservation.

POSTWAR FUNDS

Following is a summary in millions of dollars of the cash and investment balances of the operating funds at the close of fiscal year 1946:

General purposes		28.0
Other operating:		
Postwar Rehabilitation	7.2	
Postwar Construction and Improvement	23.7	
All other operating (Unemployment Administration, Soldiers' Rehabilitation, State Office Building, and Reforestation funds)	1.1	
Total other operating		32.0
Highway		39.4
Conservation		2.7
Total		102.1



Note: The composition of the 102 million dollar balance in 1946 is shown above; all except 28 million dollars is earmarked for specific purposes.

It will be noted that of the total balance shown above, 70 per cent is in the three postwar funds reserved for delayed construction and improvement of State highways and public buildings and for assistance to returning veterans; the remainder consists of working balances in funds used for normal State purposes.

Revenues earmarked for the Highway Fund are receipts from motor fuel taxes, motor vehicle license and registration fees, all other taxes or fees on motor vehicles or their operators, all Federal aid designated for highway purposes, any balance in the State Trunk Highway Fund (a fund to be used exclusively for the retirement of county highway bonds issued and for new trunk highway construction), and any other receipts for highway purposes. The Highway Commission can authorize expenditures from the fund not in excess of 36 million dollars in one year. During the fiscal year just ended 30.5 million dollars was spent for highway purposes. This is 6 million dollars more than was spent for highways in 1944 and 2 million dollars more than was spent in 1943, but is below the 34.0 million dollar average highway expenditure during 1937-42.

The Postwar Construction and Improvement Fund is to be used for additions to and improvements of State institutions. The total appropriation of 24.2 million dollars to this fund has been allocated to specific projects. This money will be put into use upon consent of the Governor, who may secure the advice of the Executive Advisory Committee, following a written statement from the department head concerned that materials and labor are available. Approximately 12.0 millions, or 50 per cent of the total, has been designated for construction and equipment at the University of Wisconsin, the general hospital in connection with the university, the teachers' colleges, and Stout Institute. Of the remaining half, 7.7 millions is for State hospitals and training schools, .5 million dollars is for Board of Health use, and 4.0 million dollars for other needed improvements in the State institutions. Expenditures from this fund to date have been approximately .5 million dollars, largely for plans and site acquisitions.

The Postwar Rehabilitation Fund is to defray the cost of the State's veteran program and is administered by the newly created Office of Veteran Affairs. So far, the office is charged with coordinating the activities of the several State agencies concerned with veteran affairs, assisting veterans having claims against the United States, providing treatment for any service-connected disabilities, extending any emergency aids, and granting loans not to exceed 750 dollars at not more than 2 per cent interest per annum for rehabilitation, education, or aid in purchase of a business. It is estimated from the *Monthly Report of the State Treasurer* that approximately 1.2 million dollars has been expended on veterans' rehabilitation during fiscal years 1945 and 1946. Since no breakdown is available of the type of expenditure made, it cannot be ascertained what portion of the amount spent will be returned in principal of loans during future years.

FUND SEGREGATION

One consequence of fund segregation, according to the purpose of the expenditure or the character of revenues for a state like Wisconsin, lies in the effect upon the size of the State cash and investment balance. Without provision for temporary loans or interfund borrowing, the more extensive the use of segregation, the larger is the aggregate balance required for operations if the State is to meet all of its obligations promptly and in full. This consequence was no doubt felt to be of slight importance relative to the desire to insure the use of highway-user taxes for maintenance and construction of highway and road facilities. The principle of fixing the level of expenditure for streets and highways by reference to the productivity of the taxes levied on highway users is widely endorsed as a general long-run policy, but it does not necessarily follow that the objective can only be attained by the segregation of highway revenues from other State funds. It can also be accomplished by planning the State's long-range program of expenditure with a view to attaining this equivalence. With consideration to the variations in yield of different elements in the State tax system, the revenues from non-highway sources can be made to meet the program of non-highway expenditure without continual withdrawals from highway earnings. The record in Wisconsin indicates that there have been substantial diversions to general expenditures of highway revenue; other needs were regarded as having a higher priority at the time such diversions took place.

The actual amount of diversion may be estimated as follows: on July 1, 1931, the balance of funds to the credit of the Highway Commission was 17.9 million dollars. This balance was reduced by 8.5 million dollars in the fiscal years 1932 and 1933, i.e., in those two years expenditures for highways exceeded revenue from the motor vehicle licenses, the fuel tax, Federal aid, and miscellaneous earnings. In the years 1934-43, the balance to the highway account increased from 1 to 6 million dollars annually, i.e., in this period highway revenues consistently exceeded highway expenditure, in the aggregate by 41.0 million dollars. The trend reversed in the fiscal years 1944 and 1945, and the balance was reduced by 8.6 million dollars. With the creation of the Highway Fund, 17.8 million dollars was transferred to it and 23.9 million dollars to the General Fund. Taking into account the lapsing of 2.0 million dollars to the General Fund in 1933-35, the net diversion of highway revenue during the 14-year period was 8.0 million dollars. This computation ignores the balance at the opening of the period (July 1, 1931). If the same method is extended back through the 1920's and property taxes for highways are deducted, the additional diversion from July 1, 1917, is 6.1 million dollars.

The equivalence of highway-user taxes and highway expenditures, if it is to be obtained, can be most easily effected not for each and every year but over a period of several years, depending upon the character of economic conditions and the State's tax system. All during the war years, for example, there were three unavoidable consequences of military requirements and priorities: the substantial postponement of outlays for highways, the sharp reduction in highway-user taxes, and the larger maintenance requirements. The equivalence of expenditure and revenue in any single year was impracticable.

State government and government in general has assumed tremendously increased responsibilities in the past two and a half decades. These responsibilities involve commitments to thousands of the State's citizens for public aids, business management of one of the country's largest enterprises—the furnishing of highway transportation facilities—and the traditional activities of government in the fields of education and public safety. Careful planning and awareness of the immediate and eventual cost of governmental services in relationship to the tax and other revenues available to pay for them can, at best, in view of economic uncertainties, supply only an approximate annual balancing of revenues and expenditures. The problems and difficulties of the executive in planning and executing the State budget are seriously aggravated by undue segregation when the alternatives of short-term borrowing are denied. The net effect of the segregation of highway funds may be both larger cash balances than otherwise necessary and, in times of financial stress, additional "temporary" taxes to finance threatened deficiencies in the General Fund. The corporation income tax, presently a substantial contributor to that fund, fluctuates widely with changes in economic conditions. Pooling these stable highway taxes with this revenue will avert some exposure to temporary financial strain.

WISCONSIN OPERATING FUNDS
RECEIPTS, DISBURSEMENTS, AND BALANCES
FISCAL YEARS 1920-46

(In millions of dollars)

Fiscal Year Ending June 30	All Operating Funds[1]								Selected Operating Funds[8] Quarterly Balances			
	Receipts[2]				Disbursements[2]			Balance End of Year[6]				
	Total	Taxes[3]	Earnings[4]	Federal Aid	Total	State Expenditures	Aid to Localities[5]		March 31	June 30	Sept. 30	Dec. 31
1920	45.5	38.0	6.1	1.4	38.6	30.6	8.0	13.8	7.2	10.0	5.6	3.8
1921	35.8	24.6	7.8	3.4	35.6	26.3	9.3	14.0	9.1	11.8	8.6	2.7
1922	38.8	26.3	7.5	5.0	38.5	28.6	9.9	14.3	9.4	12.2	10.0	5.9
1923	35.8	25.5	7.4	2.9	35.6	24.5	11.1	14.5	10.0	12.6	9.3	5.8
1924	40.1	29.1	7.9	3.1	37.4	25.1	12.3	17.2	10.0	15.4	12.1	8.5
1925	40.8	29.8	8.9	2.1	39.4	26.7	12.7	18.6	13.1	16.8	13.6	10.8
1926	44.3	33.5	8.2	2.6	44.5	29.5	15.0	18.4	9.4	16.8	14.2	9.9
1927	50.3	37.1	9.8	3.4	51.2	32.9	18.3	17.5	8.3	16.4	12.2	10.1
1928	52.6	37.6	9.8	5.2	54.3	36.4	17.9	15.8	13.7	15.0	14.7	11.4
1929	60.7	45.1	10.3	5.3	61.5	36.1	25.4	15.0	14.4	14.1	13.2	12.3
1930	71.2	52.9	10.8	7.5	65.7	38.3	27.4	20.5	16.6	19.6	18.4	16.3
1931	74.9	53.3	11.5	10.1	73.1	47.4	25.7	22.3	17.4	21.5	24.6	24.3
1932	75.1	54.5	11.3	9.3	86.1	51.8	34.3	11.3	16.5	10.5	8.7	7.5
1933	71.2	53.2	9.6	8.4	78.0	44.5	33.5	4.5	6.3	3.8	7.7	8.3
1934	87.4	55.2	9.4	22.8	78.9	30.2	48.7	13.0	6.2	12.3	10.7	11.0
1935	115.2	58.4	10.6	46.2	112.4	31.5	80.9	15.8	10.0	15.2	16.8	13.4
1936	95.4	67.1	10.4	17.9	96.1	37.2	58.9	15.1	12.4	14.7	14.3	12.5
1937	101.1	76.6	12.4	12.1	100.0	45.5	54.5	16.2	14.3	15.8	14.0	13.3
1938	110.0	79.5	13.9	16.6	109.7	51.3	58.4	16.5	15.2	16.0	14.1	7.3
1939	104.6	71.8	17.4	15.4	110.3	52.4	57.9	10.8	11.1	10.3	5.4	5.3
1940	112.7	80.0	16.6	16.1	114.4	47.8	66.6	9.1	9.3	8.7	9.0	9.4
1941	121.4	89.4	16.0	16.0	111.2	42.8	68.4	19.3	13.2	19.0	19.4	19.8
1942	138.8	103.2	16.8	18.8	124.7	50.7	74.0	33.4	30.7	33.0	31.4	30.7
1943	140.6	105.9	16.5	18.2	128.0	46.9	81.1	46.0	45.4	45.4	43.2	53.7
1944	149.7	116.0	17.0	16.7	127.5	45.6	81.9	68.2	72.0	67.6	67.7	69.4
1945[7]	152.2	117.1	21.1	14.0	134.2	48.4	85.8	86.2	77.5	85.9	85.8	88.6
1946	156.0	120.0	22.8	13.2	140.1	*	*	102.1	98.1	101.6		

[1]Consists of the General Fund, several school funds maintained as separate accounts through 1931, the Conservation Fund, the postwar and state highway funds, and minor operating funds. Specifically, the following are included: the General Fund, the University Fund Income (1920-31), the Normal School Fund Income (1920-31), the Agricultural College Fund Income (1920-31), the Public School Fund Income (1929-30), the School Fund Income, Reforestation Fund, Drainage Fund, the Service Recognition Fund (1920-23), Educational Bonus Fund (1920-23), Soldiers' Rehabilitation Fund (1924-46), the State Depository Fund (1926-36), Security Regulation Fund (1920-31), Milk Control Fund (1936-37), State Office Building Fund (1940-46), Unemployment Administration Fund (1935-46), Postwar Rehabilitation Fund (1944-46), Postwar Construction and Improvement Fund (1944-46), the Conservation Fund (1925-46), the State Trunk Highway Fund (1944), and the State Highway Fund (1945-46).

[2]Inter-operating fund transfers and investment operations are eliminated

[3]Includes state taxes on motor fuel, motor vehicles, malt beverage, and tobacco; state and local shares of state-collected public utility, insurance, liquor, and income taxes; state share only of locally-collected property, income (prior to 1933), inheritance, and miscellaneous taxes. Excludes unemployment compensation payroll taxes, teachers' insurance and retirement surtax on net income sufficient to meet actuarial requirements of the trust fund or an amount from general revenues to satisfy such requirements; also excludes amount sufficient to meet interest requirements of school fund and normal school fund. Tax receipts have been reduced by the amount of tax refunds.

[4]Includes interest earnings, tuition receipts, reimbursements for operation of charitable and penal institutions (except amounts received for intercounty payments), and miscellaneous license fees.

[5]Includes the local units' share of state-collected taxes (see footnote 3 above) and grants made for specific purposes, principally education, highways, relief, and welfare.

[6]Includes investments in the General Fund (1919-20, 1943-46), the Soldiers' Rehabilitation Fund (1926-46), the State Depository Fund (1929-31), the Postwar Construction and Improvement Fund (1944-46), the State Trunk Highway Fund (1944), the State Highway Fund (1945-46), and the Unemployment Administration Fund (1944-46).

[7]Figures for 1945 and 1946 have been estimated from the *Monthly Report of the State Treasurer* and are partially incomplete.

[8]Includes all operating funds except the State Office Building Fund and World War I bonus funds.

*Not available.

SOURCES: State of Wisconsin, *Report of the State Treasurer; Biennial Report of the Secretary of State of the State of Wisconsin;* Wisconsin Budget Bureau.

SEVENTH FEDERAL

RESERVE DISTRICT